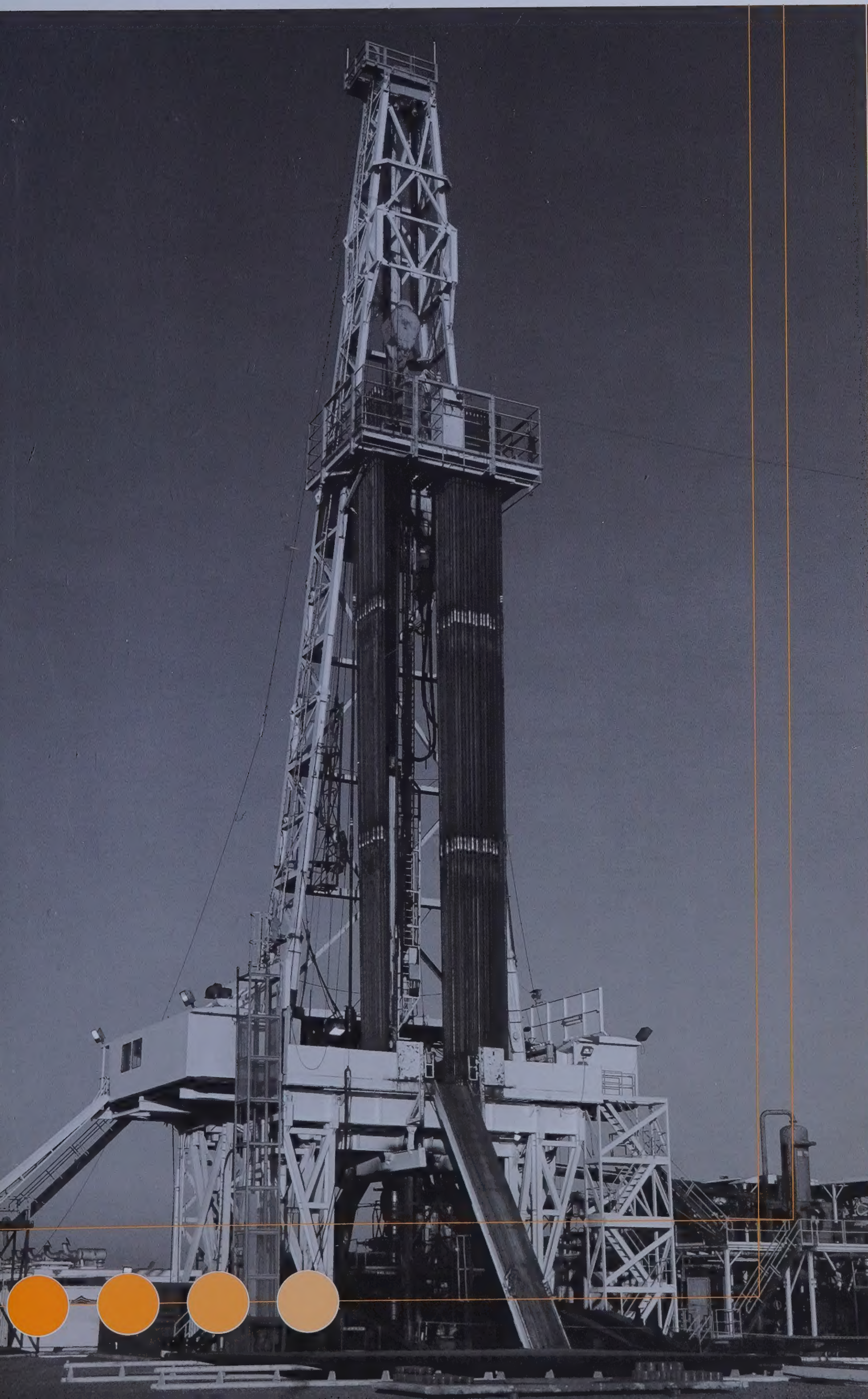
NORTHERN SUN
EXPLORATION COMPANY INC.



ANNUAL REPORT • 2005

CONTENT

HIGHLIGHTS

Increase in net capital expenditures to $11,094,762 during the year ended October 31, 2005

Increase in proceeds from the issuance of common stock to $12,360,174 during the year ended October 31, 2005

Increase in proven probable reserves as evaluated under NI 51-101 to 253,000 barrels of oil equivalent

Price realized of $56.51 per barrel of oil equivalent during year ended October 31, 2005

Operating netback of $28.49 per barrel of oil equivalent during year ended October 31, 2005

Operating cost of $10.53 per barrel of oil equivalent during year ended October 31, 2005

The following management discussion and analysis is prepared as at February 20, 2006 and should be read in conjunction with the audited financial statements for the year ended October 31, 2005 of Northern Sun Exploration Company Inc. (the "Company"). The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. All dollar figures included therein and in the following management discussion and analysis ("MD&A") are quoted in Canadian dollars. Additional information relevant to the Company's activities can be found on SEDAR at www.sedar.com.

Overview

The Company is a Canadian based oil and gas exploration company whose oil and gas properties are located in Alberta, Saskatchewan and the Northwest Territories. The Company trades on the TSX Venture Exchange under the symbol "NSE".

Results of Operations

Sales Volumes

Sales volumes, on a barrel of oil equivalent basis, averaged 183 BOE/day for the period from commencement of production in late February 2005 to October 31, 2005. There was no production during the same period in the prior year. The average daily sales volumes by product were as follows:

	Three months ended October 31, 2005	Year ended October 31, 2005 (*)
Alberta		
Natural gas (Mcf/day)	1,766	1,100
Total oil equivalent (6:1 BOE/day)	294	183

(*) Production commenced in late February 2005

The Company experienced peak production in mid-October 2005 of approximately 401 BOE/day and averaged approximately 295 BOE/day for the month of October 2005.

Results of Operations for the year ended October 31, 2005 and 2004

Revenues and Operating Netbacks

The following is a summary of the Company's operating netbacks:

(Amounts are $ per barrel of oil equivalent, unless otherwise noted)	Year ended October 31, 2005
Natural gas price ($/Mcf)	$ 9.42
Price realized oil equivalent	56.51
Royalties	17.49
Operating costs	10.53
Operating netback	$28.49

Oil and gas revenues before royalties totaled $2,615,223, with average realized prices of $56.51 per BOE for the year ended October 31, 2005. There was no revenue realized in the same period in 2004.

The Company had royalties expenses of $809,544 or approximately $17.49 per BOE during the year ended October 31, 2005. The royalty amount is comprised of gross overriding royalties and crown and crown equivalent royalties. The Company's operating expenses were $487,338 or approximately $10.53 per BOE for the year ended October 31, 2005. The Company's sole producing properties are operated by the Company.

General and Administrative Expenses

Total general and administrative expenses were $1,168,264 for the year ended October 31, 2005, compared to $593,477 for the year ended October 31, 2004 for an increase of $574,787. The increase in expenditures is a result of the Company's increased activity due to the commencement of production and further exploration and development of its oil and gas properties as compared to the comparative period in 2004 when the Company had just acquired its first oil and gas property and recently commenced exploration activities. In particular, the Company saw its fees to consultants rise to $301,965 for the year ended October 31, 2005, as compared with $117,682 for the prior year. The consulting expenses included $240,000 for technical consulting services for administering the oil and gas operations, as compared to $60,000 in the comparative period.

Interest Revenue and Expenses

Interest revenue totaled $84,783 and $2,094 for the years ended October 31, 2005 and 2004, respectively. Interest revenue in both periods was a result of investment of monies raised in equity financings during the periods and not representative of the on-going operations of the Company. Interest expense for the years ended October 31, 2005 and 2004 was $79,052 and $5,481, respectively, and was related to the associated accrued interest regarding the flow through renouncements in the fiscal years 2004 and 2003.

Depletion and Amortization

The Company recorded depletion of its oil and gas properties of $3,841,900 for the year ended October 31, 2005 compared with $506,728 in such expenditure in the comparative period in 2004. The depletion rate for oil and natural gas properties for the period is based on production volume against the proven producing reserves of the Company. Included in the depletion amount for the year ended October 31, 2005, is $1,743,462 from the write down of the Company's carrying value of property and equipment that was in excess of the value attributed to the assets by the independent reserve report. This compares with $506,728 in write downs in the prior year.

Stock Based Compensation

The Company recorded $599,648 in stock based compensation for the granting of stock options to directors, officers and consultants during the current year as compared to $195,096 in the comparative year.

Selected Annual Information

	October 31, 2005	October 31, 2004	October 31, 2003
Financial Data			
Oil and gas sales	$ 2,615,223	$ -	$ -
Royalty expenses	809,544	-	-
Operating costs	487,338	-	-
Net operating income	$ 1,318,341	$ -	$ -
Net loss	2,129,378	1,203,244	229,225
Net loss per share - basic and diluted	(0.06)	(0.12)	(0.09)
Total assets	15,928,868	3,344,073	371,276
Total long-term financials liabilities	325,034	17,626	-
Sales Volumes			
Natural gas (Mcf/day)	1,100	-	-
Total (BOE/day)	183	-	-

During the year ended October 31, 2003, the Company was reactivated as a Tier 2 oil and gas issuer. During the year ended October 31, 2004, the Company commenced exploration on its Grouard properties in Alberta and during the current year, commenced production from its Grouard, Lavoy and Battle Creek properties.

Fourth Quarter Analysis - Three months ended October 31, 2005 to the three months ended July 31, 2005

Revenues and Operating Netbacks

The following is a summary of the Company's operating netbacks:

(Amounts are $ per barrel of oil equivalent, unless otherwise noted)	Three months ended October 31, 2005	Three months ended July 31, 2005
Natural gas price ($/Mcf)	$ 11.12	$ 6.89
Price realized oil equivalent	66.75	41.33
Royalties	19.87	20.72
Operating costs	9.91	14.67
Operating netback	$ 36.97	$ 5.93

Oil and gas revenues before royalties totaled $1,805,660, with average realized prices of $66.75 per BOE for the three months ended October 31, 2005 as compared with $451,267 or $41.33 per BOE for the previous quarter ended July 31, 2005. The increase is primarily due to the commencement of production in August 2005 from the two successful wells drilled near Lavoy, Alberta.

The Company had royalty expenses of $537,498 or approximately $19.87 per BOE during the three months ended October 31, 2005 as compared to $226,296 or $20.72 in the previous quarter. The Company's operating expenses were $268,176 or approximately $9.91 per BOE for the three months ended October 31, 2005 as compared to $160,194 or $14.67 per BOE in the previous quarter. The Company's operating expenses decreased per BOE as a result of economies of scale.

General and Administrative Expenses
Total general and administrative expenses were $291,953 for the three months ended October 31, 2005, compared to $244,780 for the three months ended July 31, 2005 for an increase of $47,173. The increase in expenditures is a result of the Company's increased activity due to the commencement of production of the two Lavoy wells.

Depletion and Amortization
The Company recorded depletion of its oil and gas properties of $3,345,003 for the three month period ended October 31, 2005 compared with $283,606 in depletion in the comparative quarter. Included in the depletion amount for the three months ended October 31, 2005, is $1,743,462 from the write down of the Company's carrying value of property and equipment that was in excess of the value attributed to the assets by the independent reserve report. There was no such write down in the previous quarter.

Future Tax Recovery
The Company recorded an income tax recovery of $1,856,419 for the three month period ended October 31, 2005 compared with $174,316 in such recovery in the comparative quarter.

The Company renounced $5,968,600 effective December 31, 2004 as a result of the flow-through obligations associated with the flow-through shares issued in August 2004 and December 2004. A future tax liability of $2,176,083 was recognized in late 2004 related to the renunciations. The Company reduced the future income tax liability as it incurred losses in the previous that were previously unrecognized quarters. At October 31, 2005, there were no future tax liabilities.

Summary of Quarterly Results

Financial Data	Oct 31 2005 $	Jul 31 2005 $	Apr 30 2005 $	Jan 31 2005 $	Oct 31 2004 $	Jul 31 2004 $	Apr 30 2004 $	Jan 31 2004 $
Oil and gas sales	**1,805,660**	451,267	358,296	-	-	-	-	-
Royalty expenses	**537,498**	226,296	45,750	-	-	-	-	-
Operating costs	**268,176**	160,194	58,968	-	-	-	-	-
Net operating income	**999,986**	64,777	253,578	-	-	-	-	-
Net income (loss)	**(968,489)**	(281,055)	(531,066)	(348,768)	(744,138)	(152,674)	(151,869)	(154,563)
Net income (loss) per share - basic and diluted	**(0.03)**	(0.01)	(0.02)	(0.01)	(0.06)	(0.02)	(0.02)	(0.02)
Sales Volumes								
Natural gas (Mcf/day)	**1,766**	712	701	-	-	-	-	-
Total (BOE/day)	**294**	119	117	-	-	-	-	-

During the quarter ended April 30, 2005, the Company commenced production from its oil and gas properties and recorded revenue. The commencement of production also increased expenditures of the Company due to the recording of royalties, operating costs, depletion and accretion.

During the quarter ended October 31, 2005, the Company experienced production from its two Lavoy gas wells which increased its revenue from gas sales significantly. In addition, the Company experienced higher commodity prices from the sale of natural gas which increased revenue.

Liquidity

The Company's cash was $2,505,111 as at October 31, 2005 compared to $1,451,252 as at October 31, 2004. At October 31, 2005, the Company had a working capital deficit of $207,940 compared to working capital of $828,420 at October 31, 2004.

Cash used in operating activities was $55,473 for the year ended October 31, 2005 as compared to $647,308 for the previous year. The improvement was largely due to commencement of production from the Company's natural gas wells during the current period which provided positive cash flow to the Company's operations.

The Company received net proceeds from the issuance of its common stock of $12,360,174 for the year ended October 31, 2005 as compared to $3,752,585 for the year ended October 31, 2004. The Company used $11,094,762 of the proceeds for net expenditures on its oil and gas properties during the year ended October 31, 2005 compared with $1,286,894 during the comparative period.

If the Company is unable to obtain the financing necessary to support its operations, it may be unable to continue as a going concern. The Company currently has no commitments for any credit facilities such as revolving credit agreements or lines of credit that could provide additional working capital and uncertainty exists regarding the Company's ability to continue as a going concern. The Company has no long term debt, capital lease obligations, operating leases or any other long term obligations other than its asset retirement obligation.

The Company is committed to spend $5,968,600 in flow through eligible expenditures by December 31, 2005. At October 31, 2005, the Company had met its flow through commitment and spent $5,968,600 on flow through eligible expenditures.

Capital Resources

During the year ended October 31, 2005, the Company financed its operations from capital contributions from shareholders. During the year, the Company closed a brokered private placement of 6,136,364 flow-through common shares in its capital stock at a price of $0.55 per share and 6,550,000 non-flow-through common shares in its capital stock at a price of $0.50 per share, for total gross proceeds of $6,650,000 and net proceeds of $6,003,670. In conjunction with the financing, each flow-through common share and non-flow-through common share received a share purchase warrant which entitles the holder thereof to purchase one additional non-flow-through common share of the Company at a price of $0.65 per share for the first year and $0.85 for the second year. Agents fees of $532,000 were paid in connection with the private placement. The agent also received 1,268,637 units exercisable at $0.50 for two years. Each unit is comprised on one share and one half of one share purchase warrant, each whole warrant exercisable to purchase one additional common share for a period of two years at a price of $0.65 for the first year and $0.85 during the second year.

As at the date of this MD&A, the Company has no other arrangement for sources of financing. Subsequent to the year ended October 31, 2005, 8,562,210 warrants were exercised for gross proceeds of $5,565,437.

Related Party Transactions

During the year ended October 31, 2005, the Company paid or accrued $121,700 (2004 - $73,450) for management fees to companies controlled by officers of the Company.

During the year ended October 31, 2005, $265,884 (2004 - $135,500) was paid or accrued to directors or companies controlled by directors of the Company for consulting and technical consulting services.

Pursuant to an agreement with Tenax Energy Inc., a related entity with a director in common with the Company, the Company agreed to pay a 2.5% gross overriding royalty on all petroleum and natural gas rights. During the year ended October 31, 3005, the Company paid or accrued gross overriding royalties of $70,413 (2004 - $nil) to Tenax.

During the year ended October 31, 2005, the Company received regulatory approval of the agreement between the Company and Kanatex Resource Management Ltd. ("Kanatex") to acquire from Kanatex, all of their interest in an option to lease all undisposed oil and natural gas rights on Reserves held by a Northern First Nation. The Company issued to Kanatex 2,000,000 escrowed commons shares, paid $100,000 in cash and paid $110,000 in technical consulting fees to February 2004, pursuant to the agreement. The Company attributed no value to the 2,000,000 shares because the shares are subject to escrow, pending a valuation report to the satisfaction of regulators. The determination on the number of shares that were issued to Kanatax was based on management's opinion of fair value. Under the terms of the agreement, the Company is obligated to pay $1 million in cash (or equivalent amount of common shares) on the earlier of first production or conveyance of the land, subject to regulatory approval. The Company has also granted a 1.5% gross overriding royalty to Kanatex on any production from the land. Kanatex is a related party to the Company by virtue of sharing a common director.

During the year ended October 31, 2005, two officers of the Company purchased 56,364 flow through common shares of the Company in a brokered private placement for a gross proceeds of $31,000. In addition, during the year ended October 31, 2005, two officers of the Company exercised 171,643 existing share purchase warrants for gross proceeds of $102,986.

Capital Expenditures

	Year ended October 31, 2005	Year ended October 31, 2004
Land and undeveloped lease rentals	$ 1,932,744	$ 707,540
Geological and geophysical	854,407	352,292
Drilling and completion	8,285,673	1,002,298
Well equipment and pipeline	2,917,205	52,065
Total capital expenditures	$ 13,990,029	$ 2,114,195

The Company saw its capital expenditures rise substantially during the year ended October 31, 2005. The increase was due to the Company's continued strategy to acquire additional properties, tie-in the successful exploration wells in Grouard, Lavoy and Battle Creek, and continue its exploration and development efforts on its properties.

Grouard, Alberta

In late September, 2004, the Company began its exploration program on the Grouard/Kapawe'no property. Initially the 11-33 gas test well was drilled and production tested, and a 24 Kilometer 2D seismic program was shot and processed for interpretation. The 11-33 well was subsequently equipped for production and pipelined to a third party facility and began producing gas in February 2005.

In February 2005, the Company entered into various pooling arrangements with other explorers whom owned lands adjacent to the Company's. The Company is required to complete drilling spacing units before certain wells could be drilled. The first of such joint wells, 15-32, which the Company holds a 23.6% interest, was operated by an industry partner. The well was drilled in late February 2005, logged, cased and tested for commercial quantities of gas. The well was determined to be marginal and will likely be abandoned in 2007.

In January and February 2005, the Company completed other pooling arrangements and acquired an 87.5% interest in certain Alberta Provincial Crown land rights north of the Company's existing holdings. In March 2005, the Company operated and drilled two new exploration prospects namely the 12-3 and 8-4 test wells. These wells were logged, cased and subsequently tested various zones in each well. In May 2005, the Company purchased an 87.5% interest additional crown land rights adjacent to the wells drilled in March 2005. During the month of June 2005, the Company participated in drilling a new pooled land operated by an industry partner. The 9-32 gas test well is currently standing after being logged, cased and tested. The well could be a marginal producer provided the pipeline tie-in costs do not exceed its economic value. The Company continues to evaluate the options.

In late August 2005, the Company shot additional 2D seismic across its land and proceeded to drill two Company operated new exploration wells. The wells were drilled, logged, cased and tested by early October 2005 and one of the new wells, 7-33, was subsequently pipelined and tied in for gas production which began in November 2005. The second well, 14-9, remains standing pending further evaluation.

The Company commenced the regulatory approvals process to tie-in the 8-4 and 12-3 wells for gas production in late November 2005 with construction and new gas production estimated to begin in early 2006. The Company continues to flow all its gas production in the Grouard area through a third party facility which operates under a manageable volume restriction.

The Company is in the process of finalizing plans to drill additional wells and shoot additional seismic in the Grouard area in 2006.

Lavoy, Alberta

The Company acquired the Lavoy property via a crown land sale and retains a 100% working interest. During the year ended October 31, 2005, the Company purchased seismic data and in February 2005 drilled a gas test well to a depth of 650 meters resulting in the discovery of a new gas pool. The test well encountered gas in six separate and distinct zones and began producing from both the basal quartz and regional colony zones in August 2005. The Company surveyed and licensed a follow-up well that was drilled in June 2005 into the new discovery pool based on data obtained from the initial well. The well was fracture stimulated and began producing from both a Viking sand and a Colony channel. The Company recently installed a compressor and the two wells are producing at a combined rate of 1,000 Mcf/day at October 31, 2005. The Company continues to experience third party facility line pressures which tend to reduce production from the wells and has experienced mechanical problems with dually completed production setups in the wells.

Senlac, Saskatchewan

The Company acquired the Senlac property via a crown land sale and retains a 100% working interest. During the year ended October 31, 2005, the Company purchased seismic data and in November 2005 drilled a gas test well to a depth of 800 meters encountering gas in the two separate zones. The well was successfully completed and subsequent testing indicates that the well should produce at a rate of approximately 500 to 600 Mcf/day (80 to 100 barrels of oil equivalent per day) depending on third-party restrictions. A two kilometers pipeline tie-in to an existing third party facility is complete and production from the new gas well has commenced.

Fort Pitt, Saskatchewan

The Company acquired the Fort Pitt property via a crown land sale and retains a 100% working interest. During the year ended October 31, 2005, the Company purchased seismic data and in November 2005 drilled a gas test well to a depth of depth of 800 meters encountering gas in various zones. The well has been successfully completed and awaits the arrival of a test unit for gas production testing.

Battle Creek, Saskatchewan
Pursuant to a farm-in agreement entered into during the year ended October 31, 2005, the Company was committed to drill at least two horizontal development wells in the existing producing Madison formation, with the additional opportunity to explore for deeper oil. The Company paid 100% of all costs to earn a 70% working interest in the wells and production. The Company has also committed to drill six vertical gas development wells in the existing producing field with a further opportunity to drill an additional infill gas wells per section. The Company paid 100% of all costs to earn a 67.5% working interest in the gas wells and production. During the period the Company drilled both horizontal development oil wells in the existing producing Madison formation, and after testing the wells abandoned them due to high water cuts associated with fractures in the reservoir. The drilling of the six vertical gas development wells in the existing producing field was completed during the latter part of the current year. During the quarter ended October 31, 2005, two of the six gas wells had commenced nominal production. The remaining gas wells are expected to begin production in the first quarter of 2006.

Divide, Saskatchewan
Pursuant to our shallow gas strategy, the Company entered into a farm-in agreement during the year ended October 31, 2005, to purchased a 50% working interest in sixteen sections of land and two existing wells and will jointly drill one exploration gas well and will re-enter the two existing wells to fracture stimulate them to enhance deliverability. The Company plans to drill additional gas wells in the area after evaluation of the initial well results and will pay 50% of all costs to earn a 50% working interest in any follow-up well activity. The Company paid $500,000 to acquire a 50% interest and participate in the Divide joint venture. To date, the Company has drilled one well and is awaiting long term test results. The Company purchased an additional seven sections of land in the Divide area with the Company's joint venture partner and purchased an additional six sections of land which the Company owns 100%.

Bittern Lake, Alberta
Pursuant to a farm-in agreement executed during the year ended October 31, 2005, the Company drilled one exploration gas test well into the Ellerslie formation with the possibility of a deeper Leduc oil test with a rolling option to continue to develop the gas and or oil play. The Company paid 100% of all costs to earn a 67.5% working interest in the well and any resulting production. The Company drilled the exploration well in early July 2005. The well was completed and certain zones were briefly production tested and ultimately proved to be uneconomic and the well was subsequently abandoned. The Company has no further plans for the area.

Disclosure of Outstanding Share Data

The following details the share capital structure as of the date of this MD&A.

	Expiry date	Exercise price	Number	Number
Common shares				53,338,163
Share purchase options	January 1, 2009	$0.20	581,250	
	June 30, 2009	$0.30	15,000	
	July 22, 2009	$0.30	25,000	
	January 10, 2010	$0.50	50,000	
	February 8, 2010	$0.55	1,600,000	
	April 26, 2010	$0.61	75,000	
	June 1, 2010	$0.70	50,000	2,396,250
Warrants	December 15, 2006	$0.85	4,758,473	
	December 15, 2006	$0.50	1,268,637	6,027,110

This MD&A may contain "forward looking statements" that reflect the Company's current expectations and projections about its future results. When used in this MD&A, words such as "estimate", "intend", "expect", "anticipate" and similar expressions are intended to identify forward-looking statements, which, by their very nature, are not guarantees of the Company's future operational or financial performance, and are subject to risks and uncertainties and other factors that could cause the Company's actual results, performance, prospects or opportunities to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties and factors may include, but are not limited to: unavailability of financing, failure to identify commercially viable oil or gas reserves, fluctuations in the market valuation for oil or gas, difficulties in obtaining required approvals for the development of oil or gas projects and other factors.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this MD&A or as of the date otherwise specifically indicate herein. Due to risks and uncertainties, including the risks and uncertainties identified above and elsewhere in this MD&A, actual events may differ materially from current expectations. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The term barrels of oil equivalent ("BOE") may be misleading, particularly in isolation. A BOE conversion ratio of 6:1 is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting natural gas to crude oil in the ratio of six thousand cubic feet of natural gas to one barrel of crude oil.

AUDITORS' REPORT

To the Shareholders
Northern Sun Exploration Company Inc.

We have audited the balance sheet of Northern Sun Exploration Company Inc. as at October 31, 2005 and the statement of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at October 31, 2004 and for the year then ended were audited by another Chartered Accountant, who expressed an opinion without reservation on those statements in their report dated February 11, 2005, except for note 11(c) dated March 8, 2005.

BDO Dunwoody LLP

CHARTERED ACCOUNTANTS

Calgary, Alberta
January 16, 2006

BALANCE SHEETS
As at October 31

		2005		2004
ASSETS				
Current Assets				
Cash and cash equivalents	$	2,505,111	$	1,451,252
Accounts receivable		1,234,864		70,960
Prepaids		20,000		-
Due from joint venture partners		198,903		-
		3,958,878		1,522,212
Property and equipment (Note 3)		11,969,990		1,821,861
	$	15,928,868	$	3,344,073
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current Liabilities				
Accounts payable and accrued liabilities	$	4,098,425	$	668,222
Due to related party (Note 6)		68,393		25,570
	$	4,166,818	$	693,792
Asset retirement obligation (Note 4)	$	325,034	$	17,626
	$	4,491,852	$	711,418
Shareholders' Equity				
Equity instruments (Note 5(b))	$	19,305,080	$	9,196,195
Contributed surplus (Note 5(b))		1,188,451		363,597
Deficit		(9,056,515)		(6,927,137)
		11,437,016		2,632,655
	$	15,928,868	$	3,344,073

Basis of presentation (Note 1)
Commitments (Note 7)
Subsequent events (Note 14)

APPROVED BY THE DIRECTORS:

"Chris Cooper"
Director

"John Land"
Director

The accompanying notes are an integral part of the financial statement.

STATEMENTS OF OPERATIONS AND DEFICIT

For the year ended October 31

	2005	2004
Revenues		
Oil and natural gas sales	$ 2,615,223	$ -
Royalty expense	(809,544)	-
Interest	84,783	2,094
	1,890,462	2,094
Expenses		
Accretion of asset retirement obligation	19,721	379
Depletion and amortization	3,841,900	506,728
General and administrative	1,168,264	593,477
Interest	79,052	5,481
Operating costs	487,338	-
Stock based compensation	599,648	195,096
	6,195,923	1,301,161
Loss before taxes	(4,305,461)	(1,299,067)
Future tax recovery (Note 5(b) and 11)	2,176,083	95,823
Net loss for the year	(2,129,378)	(1,203,244)
Deficit, beginning of year	(6,927,137)	(5,723,893)
Deficit, end of year	(9,056,515)	(6,927,137)
Basic and diluted loss per share	$ (0.06)	$ (0.12)
Weighted average number of shares outstanding	35,773,423	9,737,457

The accompanying notes are an integral part of the financial statements

STATEMENTS OF CASH FLOWS

For the year ended October 31

	2005	2004
Cash flows used in operating activities		
Net loss for the year	(2,129,378)	(1,203,244)
Items not involving cash:		
Accretion of asset retirement obligation	19,721	379
Depletion and amortization	3,841,900	506,728
Stock based compensation	599,648	195,096
Future tax recovery	(2,176,083)	(95,823)
Change in non-cash working capital items:		
Accounts receivable	(1,163,904)	(62,977)
Prepaids	(20,000)	2,000
Accounts payable and accrued liabilities	972,623	10,533
	(55,473)	(647,308)
Cash flows used in investing activities		
Changes in non-cash working capital - accounts payable	2,457,580	560,054
Due from joint venture partners	(198,903)	-
Property and equipment expenditures	(13,552,342)	(1,846,948)
	(11,293,665)	(1,286,894)
Cash flows provided by financing activities		
Proceeds from issuing common stock - net of share issuance costs	12,360,174	3,752,585
Due to related parties	42,823	4,170
Share subscriptions	-	(518,200)
	12,402,997	3,238,555
Increase decrease in cash during the year	1,053,859	1,304,353
Cash, beginning of year	1,451,252	146,899
Cash, end of year	2,505,111	1,451,252

The accompanying notes are an integral part of the financial statements

NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

Northern Sun Exploration Company Inc. (the "Company") is a Canadian based oil and gas exploration company whose oil and gas properties are located in the provinces of Alberta, Saskatchewan and the Northwest Territories.

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company's ability to continue as a going concern is dependent upon the Company achieving profitable results, receiving support from its lenders and attracting sufficient capital to continue to develop and explore for oil and natural gas. Management efforts to raise capital have been successful in the past. The amount shown as property and equipment represents net costs to date and do not necessarily represent present or future value. These financial statements do not reflect adjustments that would be necessary if the going concern assumption was not appropriate.

2. Significant accounting policies

These financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

(a) Property and equipment

Oil and gas properties

The Company follows the full cost method of accounting. All costs of acquiring crude oil and natural gas properties and related exploration and development costs, including overhead charges directly related to these activities, are capitalized and accumulated in one cost center. The costs associated with the acquisition and evaluation of unproved properties are excluded from the depletion base, until such time when proved reserves can be assigned to these assets. Maintenance and repairs are charged against income, and renewals and enhancements that extend the economic life of the property and equipment are capitalized.

Gains and losses are not recognized on disposition of oil and natural gas properties unless that disposition would alter the rate of depletion by 20% or more.

The Company applies a two-stage ceiling test to capitalized costs to ensure that such costs do not exceed the undiscounted future cash flows from production of proved reserves. Undiscounted future cash flows are calculated based on management's best estimate of forward indexed prices applied to estimated future production of proved reserves plus anticipated proceeds from the sale of undeveloped properties, less estimated future operating costs, royalties, future capital development costs and abandonment costs. When the carrying amount of a cost centre is not recoverable the second stage of the process will determine the impairment whereby the cost centre would be written down to its fair value. The second stage requires the calculation of discounted future cash flows from proved plus probable reserves. The fair value is estimated using the accepted present value techniques, which incorporate risks and other uncertainties when determining expected cash flows.

The costs of unproved properties are excluded from the preceding impairment test, and are subject to its own impairment test.

(b) Depletion and depreciation

Capitalized costs of proved oil and gas properties are depleted using the unit of production method based on estimated natural gas reserves before any royalty deductions as determined by independent engineers. The basis for this calculation includes the estimated future development costs of proved undeveloped reserves. Natural gas is converted using the equivalent of six thousand cubic feet of natural gas to one barrel of oil.

(c) Revenue recognition

Revenues associated with the sale of natural gas are recognized when title passes from the Company to its customers. Transportation costs are not netted against revenue but included with production costs as they are not material to disclose separately.

(d) Asset retirement obligation

During the prior year, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". The Company recognizes the estimated fair value of an Asset Retirement Obligation (ARO) in the period in which it is incurred when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability with a corresponding increase in the carrying amount of the related asset. ARO obligations are initially measured at fair value and subsequently adjusted for the accretion of discount and any changes to the underlying cash flows. The capitalized amount is depleted on a unit-of-production basis over the life of the proven reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO. Actual costs incurred are charged against the ARO to the extent of the recorded liability. Any difference between the actual costs incurred and the recorded liability is recognized as a gain or loss in the period in which the costs are incurred.

(e) Joint venture accounting

The Company conducts a portion of its crude oil and natural gas exploration and production activities through joint ventures, and the accounts reflect only its proportionate interest in such activities.

(f) Per share amounts

Basic loss per common share is computed by dividing earnings from operations by the weighted average number of common shares outstanding for the period.

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that proceeds received from the exercise of in-the-money stock options and other instruments, are used to repurchase common shares at the average market price of the period. Basic net earnings (loss) per common share are determined by dividing net earnings (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share are computed by giving effect to the potential dilution that would occur if stock options and other dilutive instruments were exercised.

(g) Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are based on the differences between assets and liabilities reported for accounting purposes from those reported for income tax purposes. The rates used in the future income tax calculation are enacted or substantively enacted at the time of the calculation. The effect of a change in rates on future tax assets and liabilities is recognized in income in the period in which the change occurs.

(h) Financial instruments

The Company's financial instruments include cash, cash equivalents, accounts receivable, due from joint venture partners, accounts payable and accrued liabilities, and amounts due to related parties. In the opinion of management, the Company is not exposed to significant credit or interest risk, except as disclosed. The carrying amounts of these financial instruments approximate their fair market values because of the short-term maturity of these items.

(i) Stock-based compensation and other stock-based payments

The Company uses the fair value method of accounting for the share option plan (Note 5). Under this method, compensation cost is measured at fair value using the Black Scholes option pricing model at the date of grant and expensed over the vesting period of the option.

Transactions to acquire goods or services by granting equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instruments, whichever is more reliably measured.

(j) Measurement uncertainty

Amounts recorded for depletion, depreciation, amortization and accretion and amounts used for the ceiling test calculation are based on estimates of crude oil and natural gas reserves and future costs required to develop and reclaim and abandon those reserves.

The Black Scholes option valuation model was developed for use in estimating the fair value of traded options and warrants which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options and warrants have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and warrants.

The capital expenditures classification made by the Company with respect to the renouncement of flow-through shares is based on estimates from geologic information obtained and the classification of the expenditures may be challenged by the taxation authorities and in this regard the assessments may be different from that of management.

The operations of the Company are complex, and related tax interpretations, regulations and legislation affecting the Company are continually changing.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(k) Flow through shares

Resource expenditure deductions for income tax purposes related to exploratory activities funded by flowthrough share arrangements are renounced to investors in accordance with income tax legislation. The Company provides for the future effect on income taxes related to flow-through shares as a reduction of share capital and an increase in future income tax at the date of the renunciation.

(l) Hedging

Effective January 1, 2004, the Company has implemented CICA Accounting Guideline (AcG-13), "Hedging Relationships", which is effective for fiscal years beginning on or after July 1, 2003. AcG-13 addresses the identification, designation, documentation and effectiveness of hedging transactions for the purposes of applying hedge accounting. It also established conditions for applying or discontinuing hedge accounting. Under the new guideline, hedging transactions must be documented and it must be demonstrated that the hedges are sufficiently effective in order to continue accrual accounting for position hedges with derivatives. The Company has no hedges in place at October 31, 2005. As a result, the adoption of AcG-13 had no impact on the Company.

(m) Cash and cash equivalents

Short-term investments with maturities less than three months are considered to be cash equivalents and are recorded at cost, which approximate market value.

(n) Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

3. Property and Equipment

	Cost	Accumulated depletion, amortization and write down	Net book value
Oil and natural gas properties, October 31, 2005	$ 16,318,618	$ (4,348,628)	$ 11,969,990
Oil and natural gas properties, October 31, 2004	$ 2,328,589	$ (506,728)	$ 1,821,861

Depletion of petroleum and natural gas properties and production assets is determined using the unit of production method based upon proved recoverable reserves. General and administrative costs related to exploration and development activities of $328,849 (2004 - $152,000) have been capitalized during the year ended October 31, 2005.

At October 31, 2005, costs related to undeveloped properties of $5,983,491 (2004 - $1,804,235) were excluded from the depletion calculation.

During the year ended October 31, 2005, the Company issued 300,000 common shares at a fair value of $150,000 as a finder's fee for various farm-in agreements for properties in Alberta and Saskatchewan. This amount was capitalized as acquisition costs. The fair value of the common shares issued was based on the market price of the Company's common shares on the date the finder's fee agreement was executed.

An impairment test calculation was performed on the Company's property and equipment at October 31, 2005 in which the estimated discounted future net cash flows of the proved reserves and an estimate of the discounted future net cash flows from the probable reserves associated with the reserves report did exceed the carrying amount of the Company's property and equipment by $1,743,462 (2004 - $506,728) and is included in accumulated depletion, amortization and write-down. The following table outlines benchmark prices used in the impairment test at October 31, 2005:

Year	WTI Crude Oil US$/bbl	Exchange Rate US$/CDN$	Edm Light CrudeA Cdn$/bbl	ECO Natural Gas CDN$/mmbtu
2006	58.75	0.84	69.00	10.35
2007	52.75	0.84	62.25	8.85
2008	48.00	0.84	56.50	8.10
2009	44.25	0.84	52.25	7.55
2010	42.00	0.84	49.50	7.25
Thereafter	40.00 - 39.25	0.84	46.75 - 46.00	7.45 - 6.95

4. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties.

As at October 31	2005	2004
Asset retirement obligation, beginning of year	$ 17,626	$ -
Liabilities incurred	287,687	17,247
Accretion expense	19,721	379
Asset retirement obligation, end of year	$ 325,034	$ 17,626

The undiscounted amount of cash flows, required over the estimated reserve life of the underlying assets, to settle the obligation, adjusted for inflation, is estimated at $721,538 (October 31, 2004 - $42,665). The obligation was calculated using a credit-adjusted risk free discount rate of 9% and an inflation rate of 2%. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred with the majority of costs expected to occur between 2012 and 2015.

5. Equity Instruments

(a) Authorized

Unlimited common shares without par value

(b) Issued and outstanding

	October 31, 2005 Number of shares	Amount	Contributed surplus	October 31, 2004 Number of shares	Amount	Contributed Surplus
Common shares						
Balance, beginning of year	18,594,364	$7,509,221	$ 363,597	3,292,199	$5,406,839	$ -
Issued for property (Notes 6 and 3)	2,300,000	150,000	-	1,000,000	250,000	-
Issued for private Placements (Note 5(b))	12,686,364	4,139,718	-	12,218,406	2,015,883	-
Issued for exercise of warrants (Note 5 (d))	11,035,225	6,475,003	-	2,075,722	224,668	-
Reclassification of deemed warrant costs on exercise of warrants	-	1,975,033	-	-	51,095	-
Issued for exercise of stock options (Note 5(c))	135,000	40,500	-	18,750	3,750	-
Cancellation of escrowed shares	-	-	-	(10,713)	-	-
Stock based compensation	-	-	599,648	-	-	195,096
Add: fair value of stock options and broker warrants exercised	-	211,038	(211,038)	-	25,479	(25,479)
Share issue costs	-	(1,241,573)	436,244		(468,493)	193,980
Balance, end of year	44,750,953	$19,258,940	$ 1,188,451	18,594,364	$ 7,509,221	$ 363,597

	October 31, 2005			October 31, 2004		
	Number of shares	Amount	Contributed Surplus	Number of shares	Amount	Contributed Surplus
Warrants						
Balance, beginning of year	10,074,043	$1,782,797	$ -	1,904,762	$ 51,095	$ -
Issued (Note 5 (d))	12,686,364	2,510,282	-	9,297,286	1,782,797	-
Exercised (Note 5 (d))	(11,035,225)	(1,975,033)	-	(2,075,722)	(51,095)	-
Issued for financing costs (Note 5(b))	1,902,956	-	-	947,717	-	-
Balance, end of year	13,628,138	$ 2,318,046	$ -	10,074,043	$ 1,782,797	$ -
Less: tax benefits renounced to subscribers	-	(2,271,906)	-	-	(95,823)	-
Total equity instruments		$ 19,305,080	$ 1,188,451		$ 9,196,195	$ 363,597

During the year ended October 31, 2005, the Company closed a brokered private placement of 6,136,364 flow-through common shares in its capital stock at a price of $0.55 per share and 6,550,000 non-flow-through common shares in its capital stock at a price of $0.50 per share, for total gross proceeds of $6,650,000. In conjunction with the financing, each flow-through common share and non-flow-through common share received a share purchase warrant which entitles the holder thereof to purchase one additional non-flow-through common share of the Company at a price of $0.65 per share for the first year and $0.85 for the second year. Agent's fees of $532,000 were paid in connection with the private placement. The agent also received 1,268,637 units exercisable at $0.50 for two years. Each unit is comprised of one share and one half of one share purchase warrant, each whole warrant exercisable to purchase one additional common share for a period of two years at a price of $0.65 for the first year and $0.85 during the second year.

For accounting purposes, the Company allocated $4,139,718 of the proceeds to the common shares issued and $2,510,282 to the warrants issued, the sum of which is the total proceeds of $6,650,000.

In accordance with the terms of offerings and certain provisions of the Income Tax Act (Canada), the Company renounced for income tax purposes, exploration expenditures of $3,375,000 to subscribers of the flow-through common shares that closed in December 2004 and $2,593,600 to subscribers of flow through common shares that closed in August 2004, for which the Company will have to incur eligible expenditures by December 31, 2005. Future income tax liabilities of $2,176,083 were recorded during the year ended October 31, 2005 in connection with the renunciations of the flow through financings

(c) Stock options

Pursuant to a Stock Option Plan implemented in 2003, the board of directors may, from time to time, grant up to 10% of the outstanding shares as options for directors, officers, consultants and employees. Pursuant to the Stock Option Plan, the exercise price of options will be set by the Board at the time options are granted and cannot be less than the discounted market price, as permitted by the exchange. As a general rule, the Board grants options at fair market value on the date of grant. Options can be exercisable for a maximum of five years from the effective date. All options granted to date are vested immediately, except options granted to an investor relations consultant whose options vest quarterly as per regulatory requirements. The following schedule details the stock option activity of the Company:

	Number of common shares	Option price per share range	Weighted average exercise price	Weighted average grant-date fair value
Options outstanding, October 31, 2003	-	-	$ -	-
Granted	775,000	$0.20 - $0.30	$0.22	$0.25
Exercised	(18,750)	$0.20	$0.20	$0.23
Options outstanding, October 31, 2004	756,250	$0.20 - $0.30	$0.22	$0.24
Granted	1,825,000	$0.50 - $0.70	$0.55	$0.26
Exercised	(135,000)	$0.30	$0.30	$0.30
Cancelled	(25,000)	$0.55	$0.55	$0.26
Options outstanding, October 31, 2005	2,421,250	$0.20 - $0.70	$0.47	$0.25

The following table summarizes the stock options outstanding and exercisable at October 31, 2005:

Options outstanding	Option price	Weighted average exercise price	Weighted average remaining contractual life	Number of options currently exercisable	Weighted average exercise price of options currently exercisable
581,250	$0.20	$0.20	3.17	581,250	$0.20
15,000	$0.30	$0.30	3.67	15,000	$0.30
25,000	$0.30	$0.30	3.73	25,000	$0.30
50,000	$0.50	$0.50	4.20	12,500	$0.50
1,625,000	$0.55	$0.55	4.28	1,625,000	$0.55
75,000	$0.61	$0.61	4.49	75,000	$0.61
50,000	$0.70	$0.70	4.59	50,000	$0.70
2,421,250		$0.47	4.01	2,383,750	$0.47

The following table summarizes the stock options outstanding and exercisable at October 31, 2004:

Options outstanding	Weighted Option price	Weighted average average exercise price	Number of options remaining contractual life	Weighted average exercise price of options currently exercisable	currently exercisable
581,250	$0.20	$0.20	4.17	581,250	$0.20
100,000	$0.30	$0.30	4.67	100,000	$0.30
75,000	$0.30	$0.30	4.73	75,000	$0.30
756,250		$0.22	4.29	756,250	$0.22

During the year ended October 31, 2005, under the fair-value-based method, $599,648 (2004 - $195,096) in compensation expense was recorded in the statements of operations and deficit and credited to contributed surplus for options granted to directors, officers, employees and consultants.

The fair value of share options used to calculate compensation expense has been estimated using the Black-Scholes option pricing model with the following assumptions:

Year ended October 31,	2005	2004
Risk free interest rate	**3.00-3.25%**	3.06-3.18%
Expected dividend yield	**0%**	0%
Stock price volatility	**66% - 105%**	176-197%
Expected life of options	**5 years**	3-5 years

(d) Warrants

	Number of common shares	Weighted average exercise price
Balance exercisable, October 31, 2003	1,904,762	$0.10
Granted	10,245,003	$0.57
Exercised	(2,075,722)	$0.11
Balance and exercisable, October 31, 2004	10,074,043	$0.58
Granted	14,589,320	$0.64
Exercised	(11,035,225)	$0.59
Balance and exercisable, October 31, 2005	13,628,138	$0.64

As at October 31, 2005, the following warrants were outstanding:

Number of shares	Exercise price	Expiry date
12,359,501	$0.65	December 15, 2005
	$0.85	December 15, 2006
1,268,637	$0.50	December 15, 2006
13,628,138		

As at October 31, 2004, the following warrants were outstanding:

Number of shares	Exercise price	Expiry date
9,297,286	$0.60	August 11, 2005
776,757	$0.35	August 11, 2005
10,074,043		

During the year ended October 31, 2005, under the fair-value-based method, $436,243 (2004 - $193,980) in share issue costs was recorded in the balance sheet and credited to contributed surplus for broker warrants issued in connection with the private placement completed during the period.

The fair value of broker warrants used to calculate compensation expense has been estimated using the Black-Scholes option pricing model with the following assumptions:

Year ended October 31,	2005	2004
Risk free interest rate	3.00%	3.00%
Expected dividend yield	0%	-%
Stock price volatility	105%	176-198%
Expected life of warrants	1.5 years	1 year

(e) Escrow

As at October 31, 2005, there were 2,514,285 common shares (October 31, 2004 - 887,143) held in escrow. At October 31, 2005, 514,285 common shares were subject to a time release between 9 and 24 months and 2,000,000 common shares were subject to receipt of a qualified valuation report.

6. Related Party Transactions

During the year ended October 31, 2005, the Company paid or accrued $121,700 (2004 - $73,450) for management fees to companies controlled by officers of the Company. Management fees are included in general and administrative expenses in the statement of operations and deficit.

During the year ended October 31, 2005, $265,884 (2004 - $135,500) was paid or accrued to directors or companies controlled by directors of the Company for consulting and technical consulting services. Of the related party consulting fees, $139,817 (2004 - $75,500) was included in general and administrative expenses in the statement of operations and deficit and $126,067 (2004 - $60,000) was capitalized in property and equipment.

Pursuant to an agreement with Tenax Energy Inc., ("Tenax") a related entity with a director in common with the Company, the Company agreed to pay a 2.5% gross overriding royalty on all petroleum and natural gas rights. During the year ended October 31, 3005, the Company paid or accrued gross overriding royalties of $70,413 (2004 - $nil) to Tenax.

During the year ended October 31, 2005, the Company received regulatory approval of the agreement between the Company and Kanatex Resource Management Ltd. ("Kanatex") to acquire from Kanatex all of their interest in an option to lease all undisposed oil and natural gas rights on Reserves held by a Northern First Nation. The Company issued to Kanatex 2,000,000 escrowed common shares, paid $100,000 in cash and paid $110,000 in technical consulting fees to February 2004, pursuant to the agreement. During the year ended October 31, 2005, the Company capitalized the cash payment of $100,000 as an acquisition cost and is included in property and equipment. The $110,000 in consulting fees was included in general and administrative expenses in the statement of operations and deficit. The Company attributed no value to the 2,000,000 shares because the shares are subject to escrow, pending a valuation report to the satisfaction of regulators. The determination on the number of shares that were issued to Kanatax was based on management's opinion of fair value. Under the terms of the agreement, the Company is obligated to pay $1 million in cash (or equivalent amount of common shares) on the earlier of first production or conveyance of the land, subject to regulatory approval. The Company has also granted a 1.5% gross overriding royalty to Kanatex on any production from the land. Kanatex is a related party to the Company by virtue of sharing a common director.

During the year ended October 31, 2005, two officers of the Company purchased 56,364 flow through common shares of the Company in a brokered private placement for a gross proceeds of $31,000. In addition, during the year ended October 31, 2005, two officers of the Company exercised 171,643 existing share purchase warrants for gross proceeds of $102,986.

Except as disclosed, transactions with related parties have been recorded at the agreed to exchange amount.

At October 31, 2005, $68,393 (2004 - $25,570) was owing to officers, directors and companies controlled by officers and directors of the Company. Amounts due to related parties have normal trade payable terms. The amounts are unsecured and non-interest bearing.

7. Commitments

(a) Under a consulting agreement with Tenax, a related company by virtue of sharing a common director, the Company is committed to the payment of technical consulting fees of $10,000 per month until February 28, 2006.

(b) Under a consulting agreement with Kanatex, a related company by virtue of sharing a common director, the Company is committed to the payment of technical consulting fees of $10,000 per month until February 28, 2006.

(c) Under a management agreement with the Chief Executive Officer of the Company, the Company is committed to the payment of management fees of $11,000 per month until October 1, 2007. The Company can terminate the agreement at any time by providing six months notice.

(d) Pursuant to the flow-through common shares issued, the Company is committed to spending $5,968,600 on qualified expenditures by December 31, 2005. As of October 31, 2005, the Company has expended $5,968,600 on qualified expenditures.

8. Contingencies

The Company is subject to various regulatory and statutory requirements relating to the protection of the environment. These requirements, in addition to contractual agreements and management decisions, result in the accrual of estimated future removal and site restoration costs. Any changes in these estimates will affect future earnings.

Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities. Although the ultimate impact of these matters on net earnings cannot be determined at this time, it could be material for any one quarter or year.

9. Financial Instruments

As disclosed in Note 2(h), the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to commodity price risk and credit risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

(a) Commodity Price Risk

The Company will be subject to commodity price risk for the delivery of natural gas and crude oil. The Company may manage and minimize the risk by entering into various joint ventures with subparticipants. As at October 31, 2005, the Company has not entered into any commodity contracts.

(b) Credit Risk

A significant portion of the Company's trade accounts receivable are from working interest partners in the oil and gas industry and, as such, the Company is exposed to all the risks associated with that industry. At October 31, 2005 all of the Company's cash was held at one financial institution. At October 31, 2005 $198,903 (2004 - $Nil) was receivable from the Company's joint venture partners.

(c) Interest Rate Risk

Included in cash and cash equivalents is a 2.3% interest bearing redeemable term investment of $1,560,000 due January 2006.

10. Significant Customer

Substantially all of the Company's revenues comes from several wells, the production of which is sold to one customer. As such, the Company is exposed to concentrations of credit risk. However, due to the credit quality of the entity to which the Company sells to, credit risk and credit risk concentration is minimized.

11. Income Taxes

(a) Significant components of the future income tax asset at October 31, 2005 and 2004 include the following:

		October 31, 2005		October 31, 2004
Carrying value of property and equipment and asset retirement obligations in excess of available tax deductions	$	808,293	$	(153,773)
Share issuance costs		(296,483)		(84,525)
Non-capital losses		(981,762)		(995,781)
Valuation allowance		469,952		1,234,079
	$	-	$	-

(b) Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial 2005 income tax rates of 36% (2004 - 35%) to earnings (loss) before income taxes as follows:

		2005		2004
Expected income tax (recovery)	$	(1,506,911)	$	(454,673)
Increase (decrease) resulting from:				
Non-deductible crown payments		60,241		40,392
Resource allowance		(21,597)		(27,126)
Impact of tax rate change		26,284		-
Valuation adjustment		1,292,033		276,584
Stock based compensation		209,877		68,234
Recognition of previously unrecognized flow through benefits		(2,238,257)		-
Other		2,247		766
Provision for income taxes (recovery)	$	(2,176,083)	$	(95,823)

(c) At the end of the year, subject to confirmation by income tax authorities, the Company has approximately the following undeducted tax pools:

		2005		2004
Cumulative Canadian exploration expenses	$	3,421,263	$	139,394
Cumulative Canadian oil and gas property expenses		2,630,280		697,536
Cumulative Canadian development expenses		430,950		-
Undepreciated capital cost		2,917,205		-
Cumulative eligible capital		418		418
Non-capital losses carried forward for tax purposes with expiration dates between 2006 and 2012		2,727,116		2,845,088
Undeducted share issue costs carried forward		823,563		241,499
	$	12,950,795	$	3,923,935

These pools are deductible from future income at rates prescribed by the Canadian Income Tax Act.

12. Supplemental Disclosure of Cash Flow Information

(a) Interest and taxes paid:

		2005		2004
Interest paid	$	4,501	$	-
Corporate taxes yield	$	-	$	-

(b) Except as disclosed elsewhere in these financial statements the Company had the following noncash transactions:

(i) During the year ended October 31, 2005, the Company issued 300,000 common shares at a fair value of $150,000 as a finder's fee for various farm-in agreements for properties in Alberta and Saskatchewan as described in note 3.

(ii) During the year ended October 31, 2005, the Company issued 2,000,000 escrow common shares at no value fair value to Kanatex for all their interest in an option to lease all undisposed oil and natural gas rights on Reserves held by a Northern First Nation, as described in note 6.

(iii) During the year ended October 31, 2004, the Company issued 1,000,000 escrow common shares at a value of $250,000, or $0.25 per share, to Tenax for all their interest in the undisposed oil, natural gas and bitumen rights on Reserves held by the Kapawe'no First Nation ("Kapawe'no") of Grouard, Alberta.

13. Indemnities and guarantees

(a) In the ordinary course of business, the Company enters into contracts which contain indemnification provisions, such as loan agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, operating agreements, leasing agreements, asset use agreements etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

(b) Under the terms of certain agreements and the Company's by-laws the Company indemnifies individuals who have acted at the Company's request to be a director and/or officer of the Company, to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service. The claims covered by such indemnifications are subject to statutory and other legal limitation periods. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to beneficiaries of such indemnification agreements.

14. Subsequent events

Subsequent to the year ended October 31, 2005, 8,562,210 warrants were exercised for gross proceeds of $5,565,437.

Subsequent to the year ended October 31, 2005, the Company's production from two of its wells was materially restricted due to capacity constraints.

CORPORATE DIRECTORY

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Director, President and CEO

John Land
Director, COO

Bob Pollock
Director

Harvey Brooks
Director

Steven J. Bruk
Director and Corporate Secretary

Exploration Team

Richard Velhat, P.Eng., P.Geol.
Ian Walker, P.Geol.
Mike Smith, P.Geol
Don Seager, P.Geoph.

Registrar and Transfer Agent

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Northern Sun is listed on the TSX Venture Exchange under the symbol: NSE

NORTHERN SUN
EXPLORATION COMPANY INC.